

PREFACE: PREPARATIONS AND PERSPECTIVES

As the first casebook devoted specifically to corporate governance, this book suggests responses to unresolved issues in addition to reviewing current law and practice.¹ Although their analyses are not intended or offered as legal advice, the chapters are designed for immediate practical consideration not only by law school² and business school³ classes, but also by boards of directors, individual directors and officers, shareholders, stakeholders, and their counsel.

In order, the chapters: introduce competing theories of corporate governance (Chapter 1); analyze the directors' and officers' fiduciary duties of care (2) and loyalty (3); examine the types of shareholders (4) and the shareholders' power to nominate and elect directors (5); review the corporation's methods and philosophies of determining executive compensation (6) and of engaging in corporate social responsibility initiatives (7); address the professional ethics responsibilities of counsel (8); identify issues in comparative (international) corporate governance (9); and, finally, inquire whether any governance mechanisms can be shown conclusively to enhance the financial performance of corporations (10).

The myriad rules of corporate governance are themselves constantly evolving. New federal and state statutes, regulations, and court decisions are issued, and prior ones amended; stock exchange listing requirements are updated; and industry groups, activist investors, and other commentators generate and revise lists of "best practices." Meanwhile, corporate scandals and financial crises focus public sentiment against, and legislators' attention on, new

1. The discussions in the chapters generally reflect developments through September 1, 2012.

2. See Jenna L. LaRoche, *Corporate Governance Is "Hot Topic" for Law School Courses*, BNA Corp. Gov. Rpt., July 7, 2008, p. 80.

3. See Michael Jacobs, *How Business Schools Have Failed Business*, Wall St. J., April 27, 2009, p.A13 (noting, as a business school professor, that "[b]y failing to teach the principles of corporate governance, our business schools have failed our students").

types of perceived abuses; and resulting legislation invites critical commentary.⁴

The resulting requirements, regulations, and recommendations sometimes overlap, often remain ambiguous, and regularly invite courts to assess the reasonableness and fairness of a director's or officer's conduct.

In helping clients safely navigate through these complexities and uncertainties, lawyers must continually anticipate problems that could arise, and determine how they might be prevented or resolved. Counsel for corporations, boards, directors, officers, or shareholders thus practice what Secret Service agents call, in a much different context, "situational awareness": that is, "thinking of the many things that could go wrong, and what you would do if one of those things happened."⁵

Beyond educating their clients about existing rules, lawyers can recommend everyday practices to forestall emergencies. For example, just as marathoners are advised to avoid dehydration by drinking frequently in the early miles of their races (even when they are not yet thirsty),⁶ so can a board of directors be urged to develop and regularly review policies concerning such areas as executive compensation and conflicts of interest.

Counsel can also, well in advance, prepare strategies and tactics to be deployed in crises, rather than conducting a frenzy of initial research in the midst of such a situation. As one chess columnist recently warned his readers, "[s]erious players must master basic endgames. . . . Figuring them out during a game is difficult, if not impossible."⁷

In suggesting forward-looking measures of both kinds, *Corporate Governance: Principles and Practices* combines the features and functions of a casebook, a sourcebook, and a workbook. The text explains the concepts and major elements of the relevant laws, often including excerpts from court decisions⁸ and references to recent news reports⁹ and elements of popular culture. The footnotes and appendices indicate resources for further research; and several chapters supply draft documents (such as board minutes, committee charters, or bylaw provisions) for consideration, adaptation, and revision.

4. See, e.g., Stephen M. Bainbridge, *Corporate Governance After the Financial Crisis* 270 (2012) (concluding that the corporate governance provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, like those of the Sarbanes-Oxley Act of 2002, constitute "quack corporate governance": That is, "[a] powerful interest-group coalition centered on activist institutional investors hijacked the legislative process so as to achieve long-standing policy goals essentially unrelated to the causes or consequences of the financial crisis that began back in 2007").

5. Christopher Falkenberg, *Frequent Flier: Always Mindful of Finding the Nearest Exit*, N.Y. Times, Sept. 8, 2009, p. B6.

6. Gordon Block, *How to Train for and Run Your Best Marathon* 146-147 (1993) (recommending, "[d]o not wait until you are thirsty before you drink. By then it is too late, and you will have a tough time 'making up' the volume of water you have lost through perspiration.").

7. Dylan Loeb McClain, *They're No Fun to Learn, But Endgames Lead to Wins*, N.Y. Times, Sept. 13, 2009, p.34 (adding, "Studying endgames are [sic] the chess equivalent of eating your vegetables. Part of what makes it a chore is there is no guarantee the knowledge will ever be useful.").

8. Excerpts from commentary and caselaw do not always indicate the removal of footnotes or citations.

9. Citations to, and/or quotations from, the works of politicians are not intended to be taken as the author's endorsements, or criticisms, of those individuals personally or of their (or their respective parties') political positions.

Among the major additions introduced by the second edition of this book are:

- A set of more than fifty questions, at the end of Chapter 1, that identify general themes that underlie the study, theory, and practice of corporate governance;
- Expanded treatment, throughout Chapter 2, of the directors' responsibility to identify and reduce risk to the corporation, and of methods of doing so (including the special protections for vulnerabilities identified in some self-evaluations of cybersecurity);
- A summary, at the end of Chapter 2, of the cognitive pitfalls identified by recently-popularized research in behavioral economics; and a discussion of their practical implications for executives and their counsel in enhancing the decision-making process;
- In Chapter 3, further material on the duties of executives not to reveal the confidential information of, or to embarrass, their companies; an analysis of governance issues in bankruptcy reorganizations; and a review of the Supreme Court's recent clarification of the "honest services" liability of executives;
- Analyses, in Chapter 4, of the enforceability of forum-selection provisions, and of the ability of management to exclude from the proxy statement shareholder proposals concerning corporate risks;
- In Chapter 5, treatment of board diversity (and disclosure of the board's efforts to achieve diversity), of the current status of the SEC's "proxy access" rule, and of the composition of the nominating committee; and an expanded examination of the definition of "cause" for the removal of an officer or a director;
- Discussion, in Chapter 6, of "internal pay equity" among executives and employees, of the independence of compensation committee members and of compensation consultants, and of the effect of "say on pay" votes; and additional information on clawback policies and on linking compensation appropriately to executives' management of risk.
- In Chapter 7, treatment of governance issues related to the Supreme Court's *Citizens United* decision; and of issues raised by emerging corporate forms of "social enterprises," such as benefit corporations, flexible purpose corporations, and B Corporations;
- an updated appendix identifying dozens of useful Web sites and other resources for corporate governance research;
- three new appendices offering specific suggestions, for students and practitioners, on:
 - how to use the process of identifying and developing paper topics on corporate governance to enhance one's professional network, credentials, career, and client-base;
 - thirty categories of often-overlooked career opportunities related to corporate governance; and
 - thirty skill-building topics for practice-oriented corporate governance seminars, executive and/or associate training programs, development exercises, or self-study; and

- a special index of issues to consider when drafting articles of incorporation, bylaws, codes, policies, committee charters, meeting minutes, board resolutions, and other documents of corporate governance.

Some readers might find *Corporate Governance* most useful for its questions (hundreds of which have been added for this edition), which generally identify practical operational concerns: for example, “[s]hould a corporation adopt a policy that no directors take their own personal notes at board and/or committee meetings—or that if they do take notes, those notes should be destroyed before the directors leave the meeting room?”¹⁰ These should be productive topics for a lawyer to discuss with clients, especially since they are not usually addressed by standard corporate forms and “menus” of drafting options.¹¹

Yet this work is not a “cookbook”: many of its questions, unlike their counterparts in mathematics and science textbooks, have no precise and definitive answer to be provided “in the back of the book.” Instead, whether, when, and how to address the issues they raise could vary in practice, according to the nature of the client and of its particular situation. Moreover, a client’s response might range from postponing consideration of an issue, to developing a checklist of substantive and procedural factors for creating a future policy, to quickly formulating and adopting specific corporate rules.

Among the perspectives¹² from which practitioners, executives, investors, students, and faculty might approach the chapters’ questions are the following:

- (1) Historical: How has this issue generally been addressed?
- (2) Positive/Descriptive: How are corporations currently resolving the issue posed? What factors do they take into account in choosing procedures and/or rules to follow?
- (3) International/Comparative: How are corporations in other countries dealing with the issue?
- (4) Empirical: What percentages of which types of corporations have resolved the issue by each of the methods so far adopted? How, if at all, can such resolutions be correlated with a change in the market value of a corporation’s stock, and/or with other objective indicators of the firm’s performance?
- (5) Normative/Prescriptive: How *should* the issue be resolved, and what social and legal policies justify that resolution?
- (6) Document Drafting: What language could be added to (or revised in) an existing corporate document to resolve the issue? If a new corporate document should be created to address the matter, what type of document should it be, and what should it provide?
- (7) Legislative/Regulatory Drafting: Should this issue be addressed by legislation—and if so, by state rather than federal legislation? How should

10. Section 2.02(C)(2), Question 18a.

11. Cf. Stacy Conratt, *10 Secret Menu Items at Fast Food Restaurants*, Sept. 28, 2009, available at cnn.com/2009/LIVING/wayoflife/09/28/mf.10.secret.menu.items/index.html?iref=newssearch (identifying such unadvertised items as the “short” size of Starbucks coffee and unpublicized policies as Chipotle’s, which “says that if they have the [test] item available, they will make it for you.”)

12. See also Appendix A (suggesting approaches for identifying, and preparing seminar papers or law review articles analyzing, topics in corporate governance).

any such legislation be worded? Should it be enabling (that is, allowing corporations the option of adopting a certain practice), or mandatory (requiring that practice)?

- (8) Judicial/Litigation Drafting: Have courts deciding this issue agreed with each other? Have their opinions left practical elements of the issue vague or unresolved? In litigation of this issue, what language should counsel urge courts to adopt in their decisions?
- (9) Aspirational: To what degree should the law and culture of corporate governance extend beyond discouraging directors and officers from abusive practices (by exposing them to personal civil and/or criminal liability) to encourage them to engage in “best practices”? For instance, one leading corporate court has stated that “Delaware law does not — indeed, the common law cannot — hold fiduciaries liable for a failure to comply with the aspirational ideal of best practices.”¹³ Where are the lines between abusive, appropriate, and aspirational practices for directors and officers, and how clearly should they be drawn? When, why, and how should a lawyer recommend that a client pursue “best practices” rather than those that are legal but merely average or acceptable?
- (10) Ethical: What concerns of professional responsibility and malpractice does the resolution of the issue raise for the lawyer?

Half a century ago, a leading commentator reviewed the extraordinary degree of flexibility permitted management by corporate statutes, and mourned that

corporation law, as a field of intellectual effort, is dead in the United States. When American law ceased to take the “corporation” seriously, the entire body of law that had been built upon that intellectual construct slowly perforated and rotted away. We have nothing left but our great empty corporation statutes — towering skyscrapers of rusted girders, internally welded together and containing nothing but wind.¹⁴

Many provisions of modern corporate statutes remain flexible, enabling, and permissive rather than rigid, mandatory, and restrictive. Yet for the reasons discussed in the following chapters, today’s corporate law professors and practitioners find significant areas of the legal architecture being redeveloped and refurbished, and less wind-swept than ever.

This book attempts to provide some maps and tools for creating secure spaces within these construction zones, and for maximizing corporations’ and their participants’ potentials, plans, and progress.

13. *In re Walt Disney Co. Derivative Litigation*, 907 A.2d 693, 697-98 (Del. Ch. 2005).

14. Bayless Manning, *The Shareholder’s Appraisal Right: An Essay for Frank Coker*, 72 Yale L.J. 223, 245 n.37 (1962).